Weekly Economic and Markets Review

NBK Economic Research Department I 23 September 2018

International & MENA

Stocks rally on relief over trade war measures; Brent crude climbs above $80 as Trump calls for OPEC action

Key market indicators

Stock markets	Index	Change (%) weekly	YTD
Regional			
Abu Dhabi (ADI)	4,883	-1.03	11.03
Bahrain (ASI)	1,340	-0.37	0.63
Dubai (DFMGI)	2,764	-1.62	-17.97
Egypt (EGX 30)	14,083	-8.00	-6.23
GCC (S&P GCC 40)	1,070	-1.03	8.64
Kuwait (All Share Index)	5,148	0.16	6.56
KSA (TASI)	7,768	2.34	7.50
Oman (MSM 30)	4,495	-1.39	-11.84
Qatar (QE Index)	9,766	-2.55	14.58
International			
CSI 300	3,410	5.19	-15.39
DAX	12,431	2.53	-3.77
DJIA	26,744	2.25	8.19
Euro Stoxx 50	3,431	2.58	-2.09
FTSE 100	7,490	2.55	-2.57
Nikkei 225	23,870	3.36	4.85
S&P 500	2,930	0.85	9.58

Bond yields	%	Change (bps) weekly	YTD
Regional			
Abu Dhabi 2022	3.50	5.5	55.5
Dubai 2022	3.93	6.1	78.9
Qatar 2022	3.57	1.3	49.5
Kuwait 2022	3.47	5.3	66.5
Saudi Arabia 2023	3.79	4.5	57.5
International			
UST 10 Year	3.07	7.4	65.7
Bunds 10 Year	0.46	1.1	3.7
Gilts 10 Year	1.55	2.3	36.6
JGB 10 Year	0.13	2.0	8.1

3m interbank rates	%	Change (bps) weekly	YTD
Bhibor	3.58	0.0	85.0
Kibor	1.94	-6.3	6.3
Qibor	2.67	2.5	-6.7
Eibor	2.57	-4.1	77.5
Saibor	2.65	2.3	75.6
Libor	2.37	3.2	67.2

Exchange rates	Rate	Change (%) weekly	YTD
KWD per USD	0.303	0.02	0.45
KWD per EUR	0.356	1.31	0.25
USD per EUR	1.175	1.04	-2.06
JPY per USD	112.6	0.46	-0.10
USD per GBP	1.308	0.08	-3.23
EGP per USD	17.87	0.06	0.79

Commodities	$/unit	Change (%) weekly	YTD
Brent crude	78.8	0.91	17.84
KEC	76.72	0.08	20.82
WTI	70.8	2.59	17.15
Gold	1196.2	0.10	-8.43

Source: Thomson Reuters Datastream; as of Friday's close 21/9/2018

Overview

Despite the prospect of continued escalation in the US-China trade war, global equity markets rallied last week on relief that the latest US tariffs to be applied from this week were less punitive than feared, while pressures in emerging markets moderated. Indeed the US S&P and Dow Jones stock indices hit record highs mid-week and the 10-year government bond yield edged further above the 3.0% level on the continued strong growth outlook for the US economy.

Meanwhile in Europe, UK prime minister Theresa May came out fighting after her Brexit proposal was curtly rejected by the EU, stating that her offer was the only serious one on the table and increasing the chances of a 'no deal' outcome if no further compromises are made by the next summit in mid-October. The pound fell by 1.2% against the US dollar on Friday – its largest one day drop in over four months.

Oil prices rose again, with Brent crude finishing up 0.9% w/w at $79/bbl having breached the $80 mark earlier on, supported by continued concerns over the sanctions-related drop in Iran's output and OPEC's ability to respond. A tweet by US president Trump demanded that OPEC "get prices down now!", but some analysts believe that although Saudi Arabia – which produces around one-third of OPEC's entire output – claims to have spare capacity, it may in fact struggle to lift output much further in the near term.

The US Federal Reserve is almost certain to hike interest rates by 25 bps this Wednesday and most if not all Gulf countries are likely to increase interest rates in response. The existence of credible fixed currency pegs to the dollar, alongside large financial reserves and rising oil prices have helped shield Gulf economies from the worst of recent turbulence across emerging markets. Separately, the Kuwaiti stock market will see a landmark moment on Monday when it is upgraded to Emerging Market status by index provider FTSE, a move that will trigger fresh capital inflows.

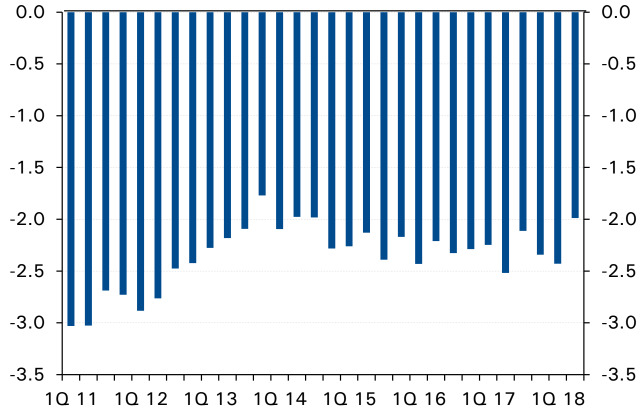
International macroeconomics

USA: The flash PMI for September fell to a 17-month low of 53.4 from 54.7 in August, possibly affected by business shutdowns on the east coast linked to Hurricane Florence though still consistent with around 3% GDP growth in 3Q18. The service sector component dropped to 52.9 from 54.8 in August, amid reports of higher selling prices due to skills shortages and higher import costs. The manufacturing component by contrast rose to a 4-month high of 55.6 on strong new orders, though firms were more downbeat about the outlook.

Meanwhile the current account deficit – a key metric in the Trump administration's drive to address "unfair" trade practices by other countries – shrank in 2Q18 to a lower-than-expected $102 billion (2% of GDP) from $122 billion (2.4% of GDP) in Q1. (Chart 1.) The improvement reflects a smaller goods deficit of $203 billion from $221 billion in Q1, helped by higher exports of soybeans to China as businesses looked to beat the start of recent tariffs.

Chart 1: US current account balance

(% of GDP)



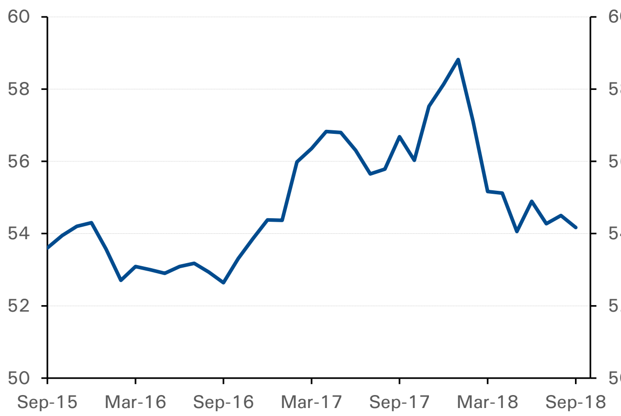
Source: Thomson Reuters Datastream

Eurozone: Eurozone data hinted at softer momentum last week, with both September's flash PMI and consumer confidence turning out softer than expected. The flash PMI registered 54.2, down from 54.5 the previous month, due to a weaker manufacturing sector driven by declines in new orders and exports, which offset healthy services activity. Meanwhile, flash consumer confidence dropped one point in August to -2.9, its lowest level in over a year, on worries over inflation and the economic outlook. (Chart 2.)

UK: Prime Minister Theresa May's plans for Britain's withdrawal and future relationship with the EU based on her 'Chequers' proposal appear to have reached the end of the road after EU leaders gave the plan a resounding thumbs down at last week's summit in Salzburg. Sterling suffered its biggest one day loss since early May on Friday, dropping 1.2% against the US dollar to $1.31 after the PM announced in a follow-up speech that negotiations with the EU had reached an "impasse", raising the risks of a no-deal Brexit. The prospect of confrontation within the Conservative Party resulting in a leadership challenge and impasse in parliament leading to possibly a general election or a second referendum, all appear ominously nearer.

Chart 2: Eurozone PMI

(index)



Source: IHS Markit

Japan: As was widely expected, the Bank of Japan (BOJ) stood pat on its monetary policy last week and maintained its positive outlook on the economy, despite growing concerns about the ongoing US-China trade dispute. The BOJ kept its short-term interest rate steady at -0.1% and vowed to continue guiding 10-year government bond yields within a range of +/-0.2% around the zero mid-point. There were also no changes in its forward guidance (first announced in July), which states that interest rates will remain low for a longer period.

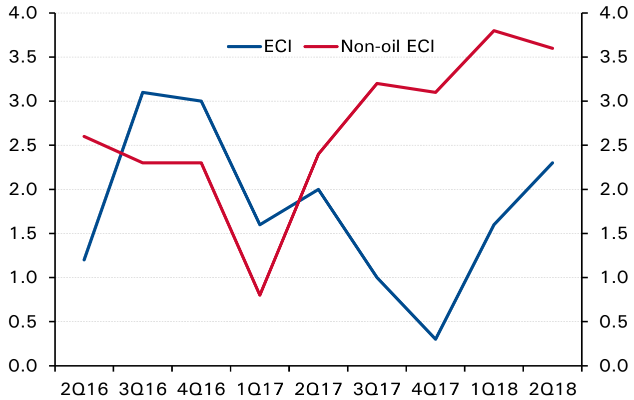
GCC & regional macroeconomics

Saudi Arabia: Capital inflows to Saudi Arabia are increasing, according to the Institute of International Finance (IIF). After experiencing private sector outflows in 1Q18 related to the narrowing of the spread between SAIBOR and LIBOR, the kingdom has recorded inflows from a $6 billion syndicated loan extension, an $11 billion loan to the Public Investment Fund, and a $3 billion international sukuk. The IIF expects stronger participation from the kingdom's various sovereign entities in international debt markets now that the Aramco IPO appears to have been suspended. Moreover, with Saudi Arabia's inclusion in the MSCI EM index from June 2019, the IIF expects inflows of at least $10 billion from passive investors and $30-40 billion from active investors in the near term.

UAE: The central bank has cut its 2018 GDP growth forecast from 2.7% (made back in April) to 2.3%, following a slight slowdown in its non-oil Economic Composite Indicator (ECI) in 2Q18. (Chart 3.) According to the ECI, non-oil GDP growth eased from 3.8% y/y in 1Q18 to 3.6% y/y in 2Q18. Nonetheless, growth in its headline ECI continued to rise, expanding from 1.6% to 2.3% during the same period, thanks largely to an improvement in the oil sector.

Chart 3: Economic Composite Indicator

(% y/y)



Source: Central Bank of the UAE

In an effort to promote longer-term growth, the UAE announced that it will allow expatriates to seek extended residency visas after retirement. Foreigners aged 55 or over will be permitted to apply for a five-year retirement visa from 2019 onwards if they have properties worth at least Dh2 million or savings of at least Dh1 million (or monthly income of more than Dh20,000).

Abu Dhabi also revealed further details of its new three-year Dh50 billion stimulus plan, which will be called 'Tomorrow 21' and allocated to four main sectors: business and investment; society; knowledge and innovation; and lifestyle. Additionally, companies based in the capital's free zones will be allowed to operate on the mainland under a dual license. This should help reduce the cost of doing business, improve competitiveness and boost foreign investments.

Egypt: For a third successive week, the finance ministry cancelled an auction of 3 and 7-year treasury bonds worth EGP3.5 billion ($196 million) on Monday. Two previous bond auctions had been cancelled after investors demanded high yields on the debt at a time of weak appetite globally for emerging market assets. Egyptian stocks tumbled 3.8% on Wednesday, their biggest drop since mid-2016, on fears of negative sentiment toward emerging markets worldwide as well as local speculation about possible currency devaluation. Meanwhile, under its privatization plan, the public enterprise ministry announced that Egypt will offer additional shares in five state companies over the next three months as part of a plan to boost the public finances.

Turkey: The Turkish lira came under renewed pressure last week after President Erdogan expressed his criticism of the central bank's larger-than-expected rate hike, saying that his patience with the bank is only "up to a point", and as investors adopted a wait-and-see approach ahead of the government's announcement of the nation's medium-term (three-year) economic plan. The lira took a further hit after Mr. Erdogan reportedly called for an investigation into Isbank, Turkey's largest lender, and its relationship to the main opposition Republican People's Party, which owns a 28% stake in the bank and which has four of its members serving on the board.

The lira was, however, given some respite towards the end of the week when Treasury and Finance Minister Berat AlBayrak rolled out the Medium Term Program. The government expects growth to ease to a lower-than-initially-forecasted 3.8% and 2.3% in 2018 and 2019, respectively, before recovering in 2020. Meanwhile, it expects inflation to rise to 20.8% in 2018 before easing to 15.9% in 2019 and below 10% in 2020. To help curb spending, the government will prioritize investments in the pharmaceutical, energy and petrochemical sectors, suspend some non-tendered projects and seek international financial assistance for some large infrastructure projects.

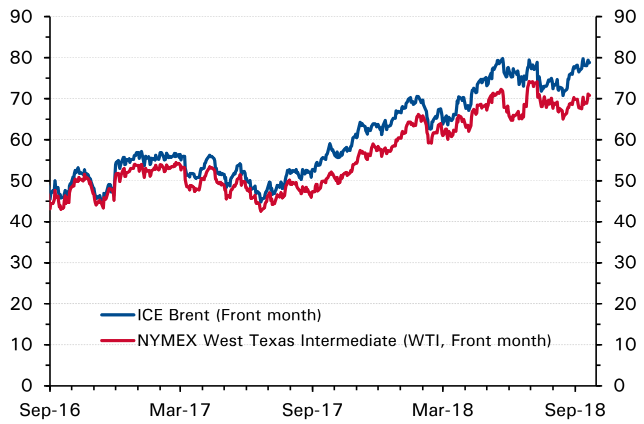
The lira also gained after Turkish banks agreed to help businesses restructure their loans to temper the rise in non-performing loans and the government reduced the required investment limits for foreigners to acquire Turkish citizenship from $2 million to $500,000.

Markets – oil

Oil prices notched up their second consecutive weekly gain on Friday, with Brent closing up 0.9% w/w at $78.8/bbl and WTI gaining 2.6% w/w to $70.8/bbl. (Chart 4.) On Friday, Brent actually broke through $80 in intraday trading as OPEC+ officials prepared to convene in Algiers to discuss production increases to offset the potential supply losses from Iran due to US sanctions that have propped up oil prices in recent months.

Chart 4: Crude oil prices

($/bbl)



Source: Thomson Reuters Datastream

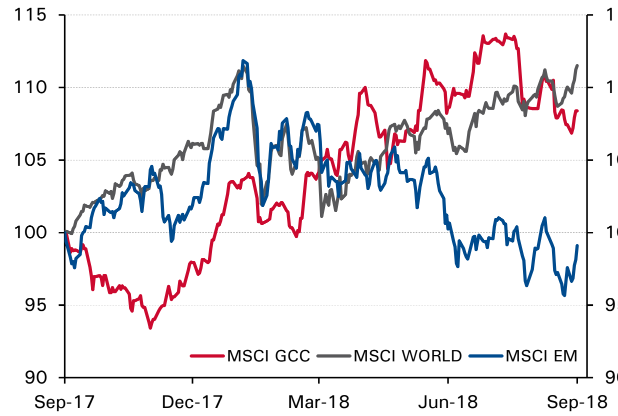
The day before, President Trump voiced his dissatisfaction with high prices, tweeting that "the OPEC monopoly must get prices down now!" While reports that OPEC+ was considering an additional 500,000 b/d of supply did send prices lower on Friday, market concerns that Saudi Arabia and its allies lack the spare capacity to compensate for Iranian losses and Venezuelan outages (among others) remain elevated. This is especially in the context of still robust oil demand; US crude inventories, for example, declined again last week, to a 3.5-year-low (394 million barrels) and to 3% below their 5-year average for September.

Markets – equities

International markets finished the week on a positive note thanks to easing trade tensions. The MSCI AC world index climbed 1.4% higher last week, supported by a 1.6% rise in MSCI's EM index. In the US, the flow of strong data helped push the DJI and S&P to record highs, finishing 2.3% and 0.8% higher w/w, respectively. Meanwhile, European stocks benefitted from the toned-down trade rhetoric, with the Euro Stoxx 50 increasing by 2.4% w/w. (Chart 5.)

Chart 5: International equity indices

(rebased, 21 September 2017=100)



Source: Thomson Reuters Datastream

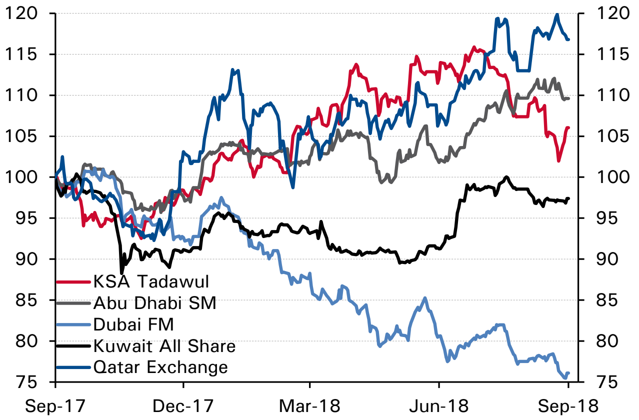
Regionally, the MSCI GCC index was up 0.9% w/w, with Saudi leading the way on the pick-up in global sentiment (+2.3% w/w). Meanwhile, Kuwait's All Share index increased by 0.2% w/w and its premier index by 0.3% as initial FTSE inflows – which boosted Thursday's total trading volume to KD 167 million – had little impact on share prices. (Chart 7.)

Markets – fixed income

International benchmark yields climbed last week on easing trade concerns, as well as strong US data. US 10-year yields rose 7 bps to 3.07%, with markets bullish about the US economy. Futures markets now pin the odds of two more rate hikes this year at 80%, with September's hike almost certain and December's increasingly likely. (Chart 7.) Bund yields moved up by 1 bps to 0.46%, and yields in GCC countries on bonds maturing in 4-5 years increased 1-6 bps. (Chart 8.)

Chart 6: GCC equity markets

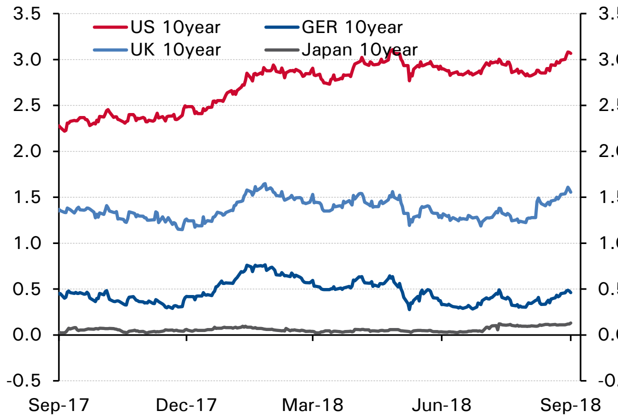
(rebased, 21 September 2017=100)



Source: Thomson Reuters Datastream

Chart 7: Global bond yields

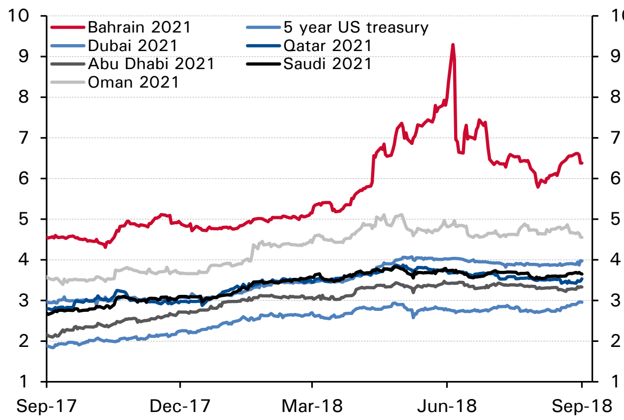
(%)



Source: Thomson Reuters Datastream

Chart 8: GCC bond yields

(%)



Source: Thomson Reuters Datastream

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